BEFORE THE STATE BOARD OF EQUALIZATION

: OF THE STATE OF CALIFORNIA

In the Matter of the Appeal of)
)
JAMES T. KING)

For Appellant: Earl R. Elkins

For Respondent: Burl D. Lack, Chief Counsel;
Crawford H. Thomas, Associate
Tax Counsel

O P I N I O N

This appeal is made pursuant to section 18594 of the Revenue and Taxation Code from the action of the Franchise Tax Board on the protest of James T. King against proposed assessments of additional personal income tax in the amounts of $358.24, $1,157.81, $776.16 and $2,629.76 for the years 1952, 1953, 1954 and 1955, respectively.

In the middle of 1941 appellant started developing a new type of hose clamp. He applied for a patent on August 6, 1941, which was granted on January 20, 1942.

On July 1, 1943, appellant executed a written agreement with the Marman Products Company, Inc. (hereafter Marman). Marman received the exclusive right to manufacture, use, and sell the patented clamps throughout the world for the life of the patent. Appellant was to receive a scheduled percentage of the sales price of the clamps sold or Marman had the option of buying the patent for a lump sum. If the scheduled payments during any year were less than $4,000, appellant had the power to terminate the agreement unless Marman then paid him the difference between the scheduled payments and $4,000. Marman could not license others or assign the agreement without appellant's permission but was granted the right to institute patent infringement suits.

On March 19, 1947, appellant filed an action against Marman in the Los Angeles Superior Court asking for an accounting, for money due him; and for damages for breach of contract.

The parties made an out-of-court settlement and executed a new written agreement on April 28, 1948. The provisions of the new agreement were substantially identical to that of 1943 except that Marman did not have the option to buy the patent for a lump sum, The new agreement explicitly superseded the 1943 contract.

On July 20, 1955, appellant and Marman agreed in writing to terminate the 1948 contract, effective May 31, 1955, releasing each other from all obligations and liabilities arising thereunder, Apparently the parties had agreed to sell the factory and patent rights to Aeroquip, Inc, of Jackson, Michigan. The details of this transaction and the terms of the assignment to Aeroquip, Inc., are not in the record before us.

For the years 1943 through 1952 appellant included the full amount of the payments from Marman in his taxable income. In his 1953, 1954 and 1955 returns, he reported such income as capital gain and included 40 percent of the amounts received in taxable income, In 1954 appellant filed claims for refund for the years 1950, 1951 and 1952 on the basis that only 40 percent of the Marman payments for those years was taxable . These claims were granted by the respondent in 1956. Later, respondent audited appellant 's returns for 1952 through 1955 and proposed the additional assessments in question here on the ground that 80 rather than 40 percent of the amounts received was includible in appellant's taxable income.

For most of the years under review, section 17712 of the Revenue and Taxation Code provided that:

> In the case of any taxpayer, only the following percentages of the gain or loss recognized upon the sale or exchange of a capital asset shall be taken into account. in computing net income:
>
> 100 percent if the capital asset has been held for not more than 1 year;
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> 80 percent if the capital asset has been held for more than 1 year but not for more than 2 years;
>
> 60 percent if the capital asset has been held for more than 2 years' but not for more than 5 years;

40 percent if the capital asset has been held for more than 5 years but not for more than 10 years;

30 percent if the capital asset has been held for more than 10 years.

-(See also Rev, & Tax . Code § 18151, in effect June 6, 1955.)

The position of the Franchise Tax Board is that the 1943 contract with Marman, under which appellant granted the exclusive, worldwide right to manufacture, use and sell the patented clamps, constituted the sale of a capital asset. (See Waterman v. MacKenzie,' 138 U.S. 252 [34 L. Ed. 923]; Watson v. United States, 222 F.2d 689.) Appellant's position on this point is unclear. If the 1943 contract was a license rather than a sale, however, then the very similar 1948 contract could only be interpreted as a license and none of the payments would be entitled to capital gain treatment. Since the parties agree that all of the payments constituted capital gain, we will proceed upon the assumption that the 1943 contract resulted in a sale.

The Franchise Tax Board contends that appellant held his patent rights for a period extending from August 6, 1941, to July 1, 1943, the date of the first Marman contract. Since this was more than one but less than two years, respondent concluded that 80 percent of appellant's gain was taxable.

Appellant has offered argument to the effect that his holding period extended from August 6, 1941, to the date of the second Marman contract, April 28, 1948. This position, was based on the fact that the second agreement expressly superseded the first. Appellant contended that the first contract was, therefore, null and void and that the second contract controlled the holding period. Carrying this novel principle one step further, appellant's position now is that the eventual cancellation of the 1948 contract extended the holding period to May 31, 1955, a period of over ten years. Thus, it is argued, only 30 percent of the payments received during the years 1952 through 1955 is includible 'in appellant's taxable income,

If appellant's approach were adopted it would permit a taxpayer to manipulate at will the holding period of an asset by simply substituting superseding but otherwise identical contracts, Needless to say, appellant has not referred us to any authorities which support his proposition. The cases he relies upon, Borin Corp., 39 B.T.A. 712, aff'd, 117 F.2d 917, cert. denied, 314 U.S. 638 [86 L. Ed. 512], and Blackstone'

Theatre Co., 12 T.C. 801, are inapposite, Those cases dealt with the problem of the basis of certain assets, not with the question of their holding period and do not, in our opinion, support appellant's contentions in any way,

If appellant parted with sufficient rights to his patents under the 1943 agreement to entitle him to capital gains treatment, his holding period would begin from the date of reacquisition and he would not be able to go back and pick up his original holding period or include the time the assets were out of his hands. (Max H. Wyman, 33 T.C. 622.) Thus, if the 1948 contract effected a rescission of the 1943 agreement, resulting in the momentary reacquisition of the patent rights, a new holding period would begin at that point, . However, nothing in the record shows that appellant ever reacquired sufficient rights in the patents to establish a new holding period. While the 1948 agreement superseded the earlier one, the right to manufacture, use and sell the patented clamps remained at all times in Marman's hands until it was apparently transferred to Aeroquip, Inc.

Relying upon Bull v. United States, 295 U.S. 247 [79 L. Ed. 1421] appellant also contends that he may recoup overpayments in tax for the years 1943 to 1949 against the deficiency assessments asserted here for the years 1952 through 1955, even though he is barred by the statute of limitations from claiming refunds for those earlier years. Bull v. United States, supra, involved a single fund from which the government had exacted both estate and income taxes on inconsistent theories. The United States Supreme Court, stressing the importance and desirability of statutes of limitation, has since confined the Bull decision to its facts. (Rothensies v. Electric Storage."' Battery Co., 329 U.S. 296 [91 L. Ed, 296].)

Here, the same item of income has not been taxed twice on inconsistent theories, as was the case in Bull v. United States. The taxable events which gave rise to the deficiencies here on appeal were the receipts of income in the years 1952 through 1955. The alleged overpayments arose from receipts of income in earlier years which were separate, distinct taxable events.

Section 19053 of the Revenue and Taxation Code provides, so far as is material here, that

> No credit or refund shall be allowed or made after four years from the last day prescribed for filing the return or after one year from the date of the overpayment, whichever period expires the later, unless before the expiration of such period a claim therefor is filed by the taxpayer.,,,

Appellant has not referred us to, nor have we in our independent research discovered any clear and compelling authority which would justify overriding the limitation thus prescribed by the Legislature.

O R D E R

Pursuant to the views expressed in the opinion of the board on file in this proceeding, and good cause appearing therefor,

IT IS HEREBY ORDERED, ADJUDGED AND DECREED, pursuant to section 18595 of the Revenue and Taxation Code, that the action of the Franchise Tax Board on the protest of James T. King against the proposed assessments of additional personal income tax in the amounts of $358.24, $1,157.81, $776.16 and $2,629.76 for the years 1952, 1953, 1954 and 1955, respectively, be and the same is hereby sustained,

Done at Sacramento, California, this 27th day of October, 1964, by the State Board of Equalization;

Paul R. Leake, Chairman

Member

Member

Member

Member

Attest: J. K. Freeman, Secretary